

State Notes

TOPICS OF LEGISLATIVE INTEREST

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Michigan's Changing Economy: The Impact on State Sales Tax Collections **By Gary S. Olson, Director**

Much has been written in recent years regarding the changes that have been occurring in both the United States and Michigan economies. One of these changes involves the fact that personal consumption expenditures have been gradually shifting from the consumption of goods to the consumption of services. While Michigan consumers still purchase a large number of goods, there clearly is a trend toward the purchase of a greater level of services as a percentage of overall consumer expenditures. Purchases of such services as medical services, legal services, home services, and numerous other services have become an increasingly important component of the average consumer's overall expenditures.

This trend toward the purchase of services, at the expense of the purchase of goods by consumers, does have an impact on the collection of State tax revenue. This article examines this trend in the context of collections of the State sales and use tax. In Michigan, with few exceptions, the statutory base of the State sales and use tax includes the purchase of most goods, but excludes the purchase of most services. For example, if a Michigan consumer buys a lawnmower to mow his or her lawn, this purchase is taxable under the State sales tax. If the same Michigan consumer decides to have his or her lawn mowed by a private lawn care provider, the charge the consumer pays for this service is not subject to the State sales tax. This type of scenario affects the level of State sales and use tax collections.

In an effort to explore this shifting of consumer expenditures and its potential impact on State tax collections, the Senate Fiscal Agency has compared the taxable base of the State's sales and use taxes with the level of personal consumption in the State, measured by Michigan personal income, for the period fiscal year (FY) 1976-77 through FY 2002-03. Table 1 provides the data. During FY 1976-77, the base of the State's sales and use taxes equaled 49.8% of Michigan personal income. During FY 2002-03 the base of the State's sales and use taxes accounted for only 41.9% of Michigan personal income. As one can observe by carefully reviewing the data in Table 1, there has been a distinct downward trend in this percentage over the past 27 years. If the data are broken down into three periods of nine years each, the average for the FY 1976-77 through FY 1984-85 period equals 47.1%, the average for the FY 1985-86 through FY 1993-94 period equals 45.1%, and the average for the FY 1994-95 through FY 2002-03 period fell to 43.3%.

The overall trend toward the purchase of fewer goods and more services cannot entirely explain the decline in the taxable base of the sales and use tax. Other factors that have contributed to this decline include statutory exemptions to the base of the sales and use tax that have been enacted during this time period, and the trend toward consumers' purchasing goods by remote means, including catalog sales and internet sales. In most instances, these remote sales, while legally subject to collection under the State use tax, are made tax free by consumers. However, the trend toward the purchase of services by consumers is a significant part of this change.

This decline in the base of the sales and use tax as a percentage of Michigan personal income has had a significant impact on the level of sales and use tax collected by the State. For example, if during FY 2002-03, the base of the sales and use tax as a percentage of personal income had equaled the average level in the FY 1976-77 through FY 1984-85 period, total sales and use tax revenue in FY 2002-03 would have increased from the actual collection of \$7.65 billion to the collection of \$8.61 billion, an increase of \$955 million or 12.5%.

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As the Governor and the Legislature review State tax policy, it is important to understand that changes in economic behavior by consumers do have an impact on State tax collections. This point will have to be considered when any comprehensive review of the State tax structure is undertaken.

Table 1

Michigan's Sales and Use Tax Base (millions of dollars)			
Fiscal Year	Sales/Use Tax Base	Michigan Personal Income	Sales/Use Tax Base as % of Personal Income
1976-77	\$35,175	\$70,666	49.8%
1977-78	39,673	78,812	50.3%
1978-79	43,480	87,544	49.7%
1979-80	43,408	93,265	46.5%
1980-81	46,018	101,114	45.5%
1981-82	45,450	104,608	43.4%
1982-83	49,463	109,162	45.3%
1983-84	56,058	120,635	46.5%
1984-85	62,100	131,316	47.3%
1985-86	66,848	140,998	47.4%
1986-87	68,655	145,970	47.0%
1987-88	71,593	154,344	46.4%
1988-89	77,278	166,096	46.5%
1989-90	78,630	174,411	45.1%
1990-91	78,655	179,536	43.8%
1991-92	80,453	189,586	42.4%
1992-93	85,880	199,577	43.0%
1993-94	93,758	213,413	43.9%
1994-95	97,118	226,193	42.9%
1995-96	103,442	234,309	44.1%
1996-97	108,034	245,823	43.9%
1997-98	112,943	260,778	43.3%
1998-99	119,745	274,918	43.6%
1999-00	127,215	291,485	43.6%
2000-01	128,098	294,537	43.5%
2001-02	129,105	298,153	43.3%
2002-03	127,540	304,593	41.9%
Average Percentage FY 1976-77 through FY 1984-85			47.1%
Average Percentage FY 1985-86 through FY 1993-94			45.1%
Average Percentage FY 1994-95 through FY 2002-03			43.3%

Source: Michigan Senate Fiscal Agency and the U.S. Department of Commerce, Bureau of Economic Analysis